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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 414

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, Debtor, and AMALGAMATED PROPERTIES, INC.,

Petitioners,

v.

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

WILLIAM P. PALMER,
Counsel for Consolidated Realty Corporation, Petitioner.

JAMES B. ALLEY,
Counsel for Realty Associates Securities Corporation, Debtor, Petitioner.

JAMES F. DEALY,
Counsel for Amalgamated Properties, Inc., Petitioner.

JOHN D. GOODLOE,
General Counsel, Reconstruction Finance Corporation, the holder of all the capital stock of Petitioner Consolidated Realty Corporation.

August, 1944.

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CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, Debtor, and AMALGAMATED PROPERTIES, INC.,

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v.

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable Harlan F. Stone, Chief Justice, and the Associate Justices of the Supreme Court of the United States:

The petition of CONSOLIDATED REALTY CORPORATION (a wholly owned subsidiary of Reconstruction Finance Corporation, hereinafter called "RFC", and owner of all the stock of Realty Associates Securities Corporation, the

Debtor herein), Realty Associates Securities Corporation, Debtor, and Amalgamated Properties, Inc. (a bondholder of the Debtor and a wholly owned subsidiary of Consolidated Realty Corporation) prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above case on August 8, 1944 (R., 378) reversing two orders of the District Court of the United States for the Eastern District of New York (R., 112-113; 355-358).

Upon application of the petitioners, the issuance of the mandate of said Circuit Court of Appeals has been stayed by appropriate order of that Court entered August 5, 1944.

Opinions Below.

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 373) is not yet reported. The judgment below (Judge Learned Hand dissenting) reversed two orders* of the District Court. In deciding the motion which resulted in the first order (R. 112-113), the District Judge rendered only an oral opinion (R. 112). The opinion (R. 352-354) of the District Judge upon which the second order (R. 355-358) was entered, is reported in 54 F. Supp. 785.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on August 8, 1944 (R. 378). The jurisdiction of this Court is invoked under Section 24(c) of the Bankruptcy Act (c. 575, §1, 52 Stat. 854 [11 U. S. C. A. 47c].) and

* The first order (R. 112-113) dated November 4, 1943, denied a motion to vacate the appointment of the Additional Trustee. The second order (R. 355-358) dated February 4, 1944, overruled objections to the retention of the Additional Trustee and continued him in office.

under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925. (c. 229, §1, 43 Stat. 938 [28 U. S. C. A. Sec. 347].)

Questions Presented.

In a proceeding for the reorganization of a corporation under the provisions of Chapter X of the Bankruptcy Act, as amended, the District Court, pursuant to Section 156 of the Act, appointed as an Additional Trustee, for the limited purpose specified in Section 189 of said Act, a director of the Debtor, whose integrity and ability are unquestioned. He is also Special Representative of RFC (the indirect owner of all the Debtor's stock) and an officer and director of other corporations in which RFC is interested, with some of which corporations the Debtor has had and is likely to have business relations. The questions are:

1. Does Section 158 of said Act apply to an Additional Trustee appointed to serve solely in the operation of the Debtor's business and in the management of its property?

2. Is an Additional Trustee appointed under Section 156 of the Act required to be disinterested within the meaning of Section 158?

3. Does Section 158 require the disqualification of a director of the Debtor from acting in the limited capacity of Additional Trustee merely because of his and RFC's dual relationships as between the Debtor and other corporations likely to have business dealings with the Debtor?

Statutes Involved.

The relevant provisions of the Bankruptcy Act, as amended, are found in the Appendix *infra,* pages 17-19.

Statement.

In approving a voluntary petition (R. 35-62) for the reorganization of the debtor corporation under Chapter X of the Bankruptcy Act, the District Judge appointed two Trustees having no prior connection with the Debtor or its affairs and an Additional Trustee who was a director of the Debtor* (R. 68-69, 77-79).

The Debtor's business consisted principally of making mortgage loans, buying, selling, holding, servicing and dealing in mortgages and other real estate securities and holding, servicing, managing and selling real estate acquired through foreclosure of mortgages (R. 35, 43). Its assets at the commencement of the proceeding were conservatively appraised at approximately $8,500,000, and its equity over and above all outstanding indebtedness was likewise estimated at upwards of $1,500,000. A large part of these assets, consisting of interests in hotels, loft buildings, factory and office buildings, apartment houses, residences, stores and practically every other type of real property, were of such a nature that their proper administration required the services of a person of broad and special experience in the mortgage and real estate field (R. 37-42, 159).

The two disinterested Trustees are lawyers, actively engaged in practice, one being President of the Brooklyn Bar Association (R. 194, 198, 199, 216). The Additional Trustee is a man of wide experience in the real estate, mortgage and banking fields, with an intimate knowledge of substan-

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* In any case where a Trustee is appointed, Section 156 of the Act specifically authorizes the appointment of a director, officer, or employee of a debtor as an Additional Trustee for the limited purposes specified in Section 189 of the Act.—operating the business and managing the property of the debtor in conjunction with the Trustee.

tially all of the Debtor's several hundred different holdings.* He has been very helpful to the distinterested Trustees in the administration of the estate and has furnished them with information and assistance in connection with the solution of problems before them that otherwise would never have been available to them (R. 196-197, 206, 215, 221-222).

The Additional Trustee has for many years been a Special Representative of RFC, which indirectly owns all of the Debtor's stock (R. 172-173, 314). In addition, he is an officer or director of other corporations in which RFC is interested, with some of which corporations the Debtor has had and is likely to have business relations. The interest of RFC in such corporations is (either directly or through petitioner Consolidated Realty Corporation), as a stockholder, a creditor, or a holder of a residual stock interest in liquidation (R. 102-103, 135, 172-173, 240-241, 292-293, 307-314, 322, 332).

RFC's interest in the Debtor and in these other corporations and the Additional Trustee's connection therewith resulted from RFC's foreclosure of the collateral pledged

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* The Additional Trustee, Mr. Jerome Thralls, has been a member of the Board of Directors of the Debtor since 1935, a member of the Debtor's Executive and Salary Committees since 1939, and also a member of various sub-committees appointed by the Board from time to time to handle complicated reorganizations and important sales of interests in real estate and other matters; he has been active in the management and operation of the Debtor's property, and is thoroughly familiar with its operations, assets and personnel (R. 83, 102, 107, 153-156, 158-161, 164, 167, 170, 176, 229, 242-243, 296, 332). He has personally inspected most of the Debtor's properties (R. 160-161, 176, 229, 298-299, 332). He took part in negotiations and had a hand in deciding everything of importance which the Board and the Executive Committee passed upon in connection with Debtor's business, including matters of policy (R. 229). Most of Mr. Thralls' time since 1934 up to the present time has been devoted to reorganizing and operating properties of various corporations, consisting of hotels, apartment buildings, etc., and mortgages and real estate securities running "into perhaps $300,000,000" (R. 174-176, 284-285, 287, 290-293, 301, 307-313).

with it to secure a $20,000,000 loan which it had made to The Prudence Company, Inc. in 1932 and the guaranty of said loan by New York Investors, Inc., the parent of The Prudence Company, Inc. The Debtor was then a subsidiary of New York Investors, Inc., and all of its capital stock, among other securities, had been pledged with RFC as collateral security for the loan. Upon acquiring the Debtor's stock RFC transferred it to petitioner Consolidated Realty Corporation, a wholly-owned subsidiary (R. 172-174).

The District Judge was thoroughly familiar with RFC's interests in the companies formerly part of the Prudence Group and with the Additional Trustee's relationship to RFC and those companies (R. 174-175, 291, 353-354).

During the pendency of the Debtor's reorganization proceedings any question relating to transactions between the Debtor and any other corporation with which the Additional Trustee is connected or in which RFC is interested, is left to the two Trustees and to the Court. The District Court requires that in the case of any sale of property, extension of mortgage, investment of Debtor's funds, or other matters of any importance in connection with the operation of the Debtor's business, application be made to it upon notice to all interested parties for authority to take action (R. 323, 354). *In re Realty Associates Securities Corporation*, 54 F. Supp. 787, 789 (E. D. N. Y., 1944).

Rulings of the Courts Below.

After full hearing before the District Court, Judge Moscowitz overruled all objections to the appointment and retention in office of the Additional Trustee. He found that

the Additional Trustee, by reason of his experience, ability, knowledge and direction of the affairs of the Debtor, was to a large degree indispensable and that his advice, assistance and direction were very essential to the management of the business. The District Court also found that, by Section 156 of the Act, Congress intended to and did authorize the appointment of an interested person as an Additional Trustee.

The Circuit Court of Appeals expressed its complete confidence in the integrity of the Additional Trustee, and indeed no one questioned his integrity or ability. The Circuit Court, by a divided Court, nevertheless reversed the District Judge. Judge Swan wrote the majority opinion in which Judge Clark concurred. Judge Learned Hand dissented.

The majority of the Court below held that under Section 158(4) of the Bankruptcy Act, the Additional Trustee was disqualified as a matter of law by reason of his "dual interests" arising out of his representation of RFC, which in turn, is interested in other corporations that have had and are "likely to continue to have business dealings with the Debtor".

In his dissenting opinion, Judge Learned Hand stated that in his view of Section 158(4), and assuming withdrawal by an "operating" [Additional] Trustee from transactions in which he might have an adverse interest, the District Court should be allowed in its discretion to decide whether it needs such "operating" trustee in those transactions in which he can act and that there is good ground for distinguishing "operating" trustees in this respect from those having general responsibility as to the reorganization.

Specifications of Errors to be Urged.

The Court below erred: (1) in holding that Section 158 of the Bankruptcy Act applied in the case of an Additional Trustee appointed pursuant to Section 156 of the Act; (2) in holding that Congress intended that Section 158 of the Act should apply in the case of such an Additional Trustee; (3) in holding that the mere existence of the dual relationships of the Additional Trustee and RFC as between the Debtor and other corporations likely to have business relations with the Debtor compelled it to reverse the orders appealed from; (4) in failing to hold that such an Additional Trustee was qualified to act as such under the said Bankruptcy Act.

Reasons Relied on for Allowance of Writ.

The reasons relied on by petitioners for allowance of a writ of certiorari by this Court are:

1. The decision of the Circuit Court of Appeals for the Second Circuit is a decision of first impression and involves an important question of Federal law, namely, the construction of basic provisions of the Federal Bankruptcy Act, which has not been, but should be, settled by this Court.

2. The decision below construes sections of Chapter X of the Bankruptcy Act which vitally affect creditors and stockholders alike in all important corporate reorganizations under the Act. These sections relate to the qualifications and functions of trustees, which constituted one of the most controversial subjects during several years of hearings and study of proposed changes in reorganization procedure under the Bankruptcy Act, by Congressional Committees, the Department of Justice, the National Bank-

ruptcy Conference, Committees from numerous Bar Associations, representatives of various credit associations, the Securities and Exchange Commission and prominent members of the Bench and Bar.*

For years it had been debated whether trustees should or should not be completely disinterested persons having no prior association with the management of a debtor. Until the making of the final amendments, recommended by the Senate Judiciary Committee shortly before its passage, the Bill had limited the appointment of trustees to disinterested persons having no prior association with the management (H.R. 8046). The functions of the disinterested trustees, as proposed by the Bill, were, among others, to investigate the affairs of the debtor and the desirability of the continuance of its business, and to formulate a plan of reorganization, in addition to operating the debtor's business and managing its properties. The provision later made, which authorized the appointment of an interested person, associated with the management, as an additional trustee for the sole purpose of serving in the operation of the business and the management of the property of a debtor, was a compromise (Senate Report No. 1916, pp. 27-28).

Under this compromise, the functions of the disinterested trustees, as proposed in the Bill, were continued but the Court was authorized to appoint a representative of the management—a director, officer or employee—to serve solely in the operation of the business and the management

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* Hearing before the House Judiciary Committee on H. R. 6439 and H. R. 8046, 75th Cong., 1st Session, Statement of Representative Chandler, pp. 2-3, 164-165, 174, 290, 327-328, 343, 367-370; Senate Report No. 1916 accompanying H. R. 8046, 75th Cong., 3rd Session, Part 2, p. 6 [1938]; Hearings before a Sub-committee of the Senate Judiciary Committee, 75th Cong., 2nd Session [1937-1938], pp. 20, 29-30, 103, 200-201.

of the property.* However, the amendment having been superimposed upon a Bill which contemplated only the appointment of completely disinterested trustees with no prior connection with the management, considerable confusion has resulted as to the qualifications required under the Act of the important office of additional trustee.

While objecting on other grounds, not relevant to the issues here involved, to the retention in office of the Additional Trustee, the Securities and Exchange Commission took the position in this case that the provisions of Section 158 of the Act did not apply to an Additional Trustee, but that an ambiguity arose from the last-minute insertion of a single sentence respecting Additional Trustees in a statutory framework built to accommodate only disinterested Trustees.**

The decision of the Court below casts in doubt the status of Additional Trustees appointed in Chapter X proceedings. The widespread view of the Bench and Bar has been

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* The Additional Trustee serves in the operation of the business and the management of the property in conjunction with the disinterested Trustee (Secs. 156 and 189 of the Act). See also Fifth Annual Report by the Securities and Exchange Commission, p. 12, where it states that the function of the Additional Trustee is limited to "assisting in the operation of the business" and refers to an unreported case.

** The brief of the S. E. C. in the Court below (at p. 20) refers to the ambiguity arising from the last-minute addition of the Additional Trustee provision. In a letter to the District Judge dated December 15, 1943, the S. E. C. stated its position with respect to the appointment of an Additional Trustee as follows:

> "(1) It is the contemplation of Section 156 of Chapter X that an additional trustee should be appointed only in unusual and exceptional cases where services and experience essential to the business operations of a trusteeship can not be obtained through the employment of the officers of a debtor;
>
> "(2) The employee, officer or director who is selected as additional trustee should be an active operating man skilled in and thoroughly familiar with the workaday problems of the business; and
>
> "(3) *A person satisfying these qualifications may serve as additional trustee even though he is not disinterested within the meaning of Section 158 of Chapter X.*" (Italics supplied.)

in accord with the conclusion of the Securities and Exchange Commission that Section 158 does not apply to an Additional Trustee. This is reflected in *Collier on Bankruptcy* (14th Ed., V. 7, p. 318, Note 3) where it is stated:

> "The additional trustee must be a director, officer or employee of the debtor and he need not have the qualifications of a disinterested trustee. §156."

Consequently it is most important that the status of Additional Trustees be clarified by this Court.

3. The provisions of Chapter X governing the qualifications and functions of trustees constituted a novel procedure introducing basic changes in corporate reorganization.

For the first time, courts were required in all cases involving over $250,000, to appoint distinterested trustees charged with investigating the affairs of the debtor, recommending whether or not the business should be continued and formulating a plan (Sections 156, 167, 169). Under Section 158 no one having any interest in, or connection with, the debtor could be deemed to be disinterested for the purpose of qualifying as such trustee.

For the first time also, provision was made for the appointment of an Additional Trustee to serve solely in the operation of the business and in the management of the property (Sec. 156).

These provisions form a vital part of a comprehensive program to regulate corporate reorganizations, designed to remove abuses of the past while protecting the interests of all concerned. The program contemplated that control of the investigation of the prior conduct of the business, and the formulation of a plan of reorganization should be removed from the debtor and vested exclusively in trustees having no prior connection with the debtor or its property. At the same time, it was also recognized that such disinter-

ested trustees would generally be unfamiliar with the business and that the efficient operation of the business and the preservation of the value of the debtor's assets might require the services of a person formerly connected with the management who was qualified by ability, experience and knowledge to protect the assets of the debtor by assisting in the operation of the business and the management of the property during the reorganization (Senate Report No. 1916, pp. 27-28). It is, therefore, highly important, in order to carry out the purposes of the Act, that the qualifications and functions of the different officers appointed under the Act be clearly defined by this Court.

4. The decision below unduly restricts the class from which Additional Trustees may be appointed, contrary to the provisions and purposes of the amendment added by the Senate. Until the question is settled by this Court, the District Judges charged with carrying out the provisions of Chapter X, as well as creditors and stockholders in all important corporate reorganizations, may be erroneously deprived of the services of those persons best qualified by ability, experience and intimate knowledge of a debtor's affairs to serve in one of the most important offices in the administration of a debtor's estate, namely, the operation of its business and the management of its property during reorganization.

As the Bill came from the House (H.R. 8046), Section 156 provided for the appointment only of disinterested trustees in every case, as follows:

> "Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees who shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that

> the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession."

Upon the recommendation of the National Bankruptcy Conference, Section 156 was amended in the Senate so as to divide the first sentence quoted above into two sentences, reading:

> "Upon the approval of a petition, the Judge shall * * * appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested * * *."

The limited purpose of this amendment was stated on behalf of the National Bankruptcy Conference as follows: "That is to make it clear that the same qualifications are required for a trustee who is appointed subsequently in the proceedings as are required when the appointment is made on the approval of the petition." Hearings before Sub-Committee of the Senate Judiciary Committee on H.R. 8046, 75th Cong. 2nd Session [1938], p. 77.

Thereafter, the last sentence of Section 156, providing for the appointment of a director, officer or employee as an Additional Trustee, was added by the Senate Committee and thereafter was adopted by both the House and the Senate in that form.

Therefore, the requirement in Section 156 that "Any trustee * * * shall be disinterested" was intended to relate, and does relate, only to the trustee who *must* be appointed under Section 156 and not to an Additional Trustee who *may* be appointed in the Court's discretion for the limited purpose of assisting in the operation of the business.

This view is confirmed by the portion of Senate Report No. 1916, 75th Congress, 3d Session, pp. 27 and 28, dealing

with the amendment to Section 156 providing for the appointment of Additional Trustees, as follows:

> "* * * However, in order to make it possible for the Court to make use of the knowledge and experience of the officers and employees of the debtor in the management and operation of the debtor's business and property as the facts of particular cases may seem to make desirable, the judge is authorized by the amendment, wherever a *disinterested* trustee has been appointed, to appoint also *any* officer, director or employee of the Debtor as an additional trustee. Such additional trustee will function as provided in Section 189." (Italics provided.)

The use of the term "any" is particularly significant and shows Congress intended no such limitation as that imposed by the Court below.

It is also to be noted that the Senate Committee speaks of a "disinterested trustee" as distinguished from the "additional trustee". The Securities and Exchange Commission has recognized the same distinction.*

The Court below disregarded the distinction drawn by Congress between the disinterested Trustee and the Additional Trustee and erroneously held that the provision in Section 156 providing that "Any trustee appointed under this chapter shall be disinterested * * *" compelled the conclusion that the Additional Trustee was required to be disinterested within the meaning of Section 158 provided only that he might be a director, officer or employee.

If Congress had intended this construction, it is reasonable to suppose that it would have enacted the second sentence of Section 156 in the following form:

> "Any trustee * * * shall be disinterested * * * provided, however, that the court may appoint a

* At p. 12 of its Fifth Annual Report to Congress it distinguishes between the Trustee who must be appointed in all cases involving over $250,000 and the Additional Trustee by referring to them as "disinterested trustee" and "interested trustee", respectively.

director, officer or employee of the debtor as an additional trustee for the purposes specified in Section 189."

In Section 156 as enacted, however, the authorization for the appointment of an Additional Trustee is placed in a separate sentence at the end of the section. Since the Additional Trustee provision was not drawn as a limited exception, it must be interpreted as a second power given to the Court, independent of the preceding direction to appoint a disinterested trustee in every case.

Having authorized the appointment of Additional Trustees from the class having the greatest possible "adverse interest," Congress did not intend to disqualify a director, officer or employee because of some relatively minor "interest." If Section 158 applies to Additional Trustees, it follows that any director, officer or employee who has a remote additional connection with the affairs of a debtor may be disqualified from assisting the disinterested Trustees in operating the business and protecting the property. Any such result would defeat the purpose of the Additional Trustee provision by unduly hampering the Courts in administering estates in reorganization.

5. The mere existence of a dual interest in a debtor and in another corporation likely to have business with it should not automatically disqualify an Additional Trustee. The policy of the Act requires that the Courts be given latitude in the selection of an officer whose function is limited solely to the operation of the business and the management of the property. In this case the District Court had, from the beginning, provided ample safeguards by requiring specific application for authority to the Court prior to any important action by the Trustees (*supra*, p. 6). Such close supervision by the Court, coupled with the withdrawal by the Additional Trustee from any transactions in which he or RFC might be interested, provides ample protection for all interested parties; the Additional Trus-

tee's activities are so limited that no question of material adverse interest to any class of creditors or stockholders can arise. The District Judge has shown that he desires the services of the Additional Trustee on this limited basis and he should not be prevented from obtaining services which he considers valuable to the operation of the business and in the best interests of all concerned. This is in line with the view of Judge Learned Hand expressed in his dissenting opinion.

Conclusion.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari should be granted to review the judgment of the court below.

WILLIAM P. PALMER,
Counsel for Consolidated Realty Corporation, Petitioner.

JAMES B. ALLEY,
Counsel for Realty Associates Securities Corporation, Debtor, Petitioner.

JAMES F. DEALY,
Counsel for Amalgamated Properties, Inc., Petitioner.

JOHN D. GOODLOE,
General Counsel, Reconstruction Finance Corporation, the holder of all of the capital stock of Petitioner Consolidated Realty Corporation.

Believing that the question of review of the decision below is worthy of consideration by this Court, I have authorized the filing of the foregoing petition.

CHARLES FAHY,
Solicitor General of the United States.

August, 1944.

Appendix.

SECTION 156—*Appointment of Trustees.*

"Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor."

SECTION 158—*"Disinterested Person" Defined.*

"A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this act, if—

"(1) he is a creditor or stockholder of the debtor; or

"(2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

"(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

"(4) It appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders."

SECTION 167—*Duties of Trustee.*

"The trustee upon his appointment and qualification—

"(1) shall, if the judge shall so direct, forthwith investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge;

* * * * * *

"(5) shall, at the earliest date practicable, prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, in such form and manner as the judge may direct, to the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate; and

"(6) shall give notice to the creditors and stockholders that they may submit to him suggestions for the formulation of a plan, or proposals in the form of plans, within a time therein named."

SECTION 169—*Submission of Plan.*

"Where a trustee has been appointed the judge shall fix a time within which the trustee shall prepare and file a plan, or a report of his reasons why

a plan cannot be effected, and shall fix a subsequent time for a hearing on such plan or report and for the consideration of any objections which may be made or of such amendments or plans as may be proposed by the debtor or by any creditor or stockholder."

SECTION 189—*Operation of Business.*

"A trustee or debtor in possession, upon authorization by the judge, shall operate the business and manage the property of the debtor during such period, limited or indefinite, as the judge may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate."

(10)

SEP 22 1944
CHARLES ELMORE CROPLEY

Supreme Court of the United States

October Term—1944.

No. 414.

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, Debtor and AMALGAMATED PROPERTIES, INC.,

Petitioners,

AGAINST

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN,

Respondents.

Brief of Respondents in Opposition to Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

LLOYD B. KANTER, JULIUS SILVER,
Counsel for Bondholders' Protective Committee, Respondents.

PERCIVAL E. JACKSON,
Counsel for John Vanneck, Barbara B. Vanneck, Equitable Holding Corporation, Vanneck Realty Corporation and Frank Bailey, Respondents.

ARCHIBALD PALMER,
Counsel for Anna Kuhlmann and Catherine Kuhlmann, Respondents.

LODER APPEAL PRESS, INC., 65-67 Duane St., N. Y. C., Tel. WOrth-2-0689

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Supreme Court of the United States

No. 414.

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, Debtor and AMALGAMATED PROPERTIES, INC.,

Petitioners,

AGAINST

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN,

Respondents.

Brief of Respondents in Opposition to Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Preliminary Statement.

This brief is submitted by the respondents Edwin B. Meredith, Jacob R. Schiff and Milton C. Zaidenberg, constituting the Bondholders' Protective Committee and by John Vanneck, Barbara B. Vanneck, Equitable Holding Corporation, Vanneck Realty Corporation and Frank Bailey; Anna Kuhlmann and Catherine Kuhlmann, bondholders of the Debtor, in opposition to the petition for a writ of certiorari to review the judgment of the Circuit

Court of Appeals for the Second Circuit, reversing two orders of the District Court of the United States for the Eastern District of New York, which orders denied motions to vacate the appointment of the additional trustee and overruled objections to the continued retention of the additional trustee in office.

Opinions Below.

The opinion of the Circuit Court of Appeals for the Second Circuit (R. 373) is not yet reported. The judgment below (Judge Learned Hand dissenting) reversed two orders of the District Court. In deciding the motion which resulted in the first order (R. 112-133), the District Judge rendered an oral opinion (R. 112). The opinion (R. 352-354) of the District Judge, upon which the second order (R. 355-358) was entered, is reported in 54 F. Supp. 785.

The Petitioners.

The petitioners are the Debtor, Realty Associates Securities Corporation, its sole stockholder, Consolidated Realty Corporation and Amalgamated Properties, Inc., a wholly owned subsidiary of the common stockholder, appearing herein as a bondholder of the Debtor.

Statement of the Case.

We omit a complete statement of facts herein and rely therefor on the memorandum of the Securities and Exchange Commission. In the course of the argument, we will set forth such facts as are particularly pertinent thereto.

Rulings of the Courts Below.

Respondents who constitute the Bondholders' Protective Committee moved to vacate the appointment of Mr.

Thralls as additional trustee; that motion was denied on November 4, 1943 (R. 112, 113). At the hearing held pursuant to the provisions of Sections 161 and 162 of the Chandler Act all respondents and the Securities and Exchange Commission objected to his continued retention as additional trustee.

The bases of the objection, and the issues raised by the present respondents on the appeal below (the District Court having overruled the objections) were threefold:

1. That an operating Trustee should be appointed only in the exceptional case and there was no need for the appointment of one in this proceeding.

2. That were one needed only an operating official of the company, which Mr. Thralls was not, should have been selected.

3. That Mr. Thralls had adverse interests which in any event disqualified him from acting as a trustee.

The Circuit Court of Appeals found it unnecessary to pass upon the first two issues. It decided the appeal, and reversed the orders of the District Court, upon the third ground. It held that Mr. Thralls as an additional trustee and as the representative of the Reconstruction Finance Corporation in many corporations of the Prudence Group with which the Debtor had and is likely to have business dealings will, necessarily, be under a cross-fire of conflicting loyalties. It concluded that the appointment of a person having such dual interests was improper; that section 158 (4) expressly forbade it and there was nothing in the words or policy of Section 156 to preclude giving effect to that rule.

This determination necessarily rendered the former questions moot and, as we will demonstrate herein, the decision of the Circuit Court that a person having dual interests could not be appointed a trustee, in fact and effect, merely required the application of *a well-settled substantive rule applicable to all trustees in bankruptcy, whether reorganization or otherwise, equity receivers and fiduciaries generally.*

We submit further, *that petitioners are not aggrieved parties* and, therefore, they have no right to attempt to review the determination made below that a particular individual, Mr. Thralls, should not act as trustee, additional or otherwise.

Questions Presented.

We submit, therefore, that the questions presented by this petition for certiorari are:

1. May a director of the Debtor be appointed as additional trustee in a Chapter X proceeding, where by reason of his official connection with other corporations which had and will continue to have business transactions with the Debtor, he is acting in a dual capacity and is subject to a cross-fire of conflicting loyalties?

2. Are petitioners entitled to seek a review of the determination of the Circuit Court of Appeals removing an additional trustee?

ARGUMENT.

I.

The Circuit Court of Appeals has merely stated and applied the unquestioned rule that a person with dual interests and conflicting loyalties may not act as trustee.

The record discloses that since October, 1935, Mr. Thralls has been the employee of Reconstruction Finance Corporation, the indirect owner of all the common stock of the Debtor herein (R. 284, 172, 173). He became a member of the Board of Directors of the Debtor in March, 1935, to represent the interests of Reconstruction Finance Corporation (R. 305, 319) and a member of its Executive Committee in 1939 (R. 305). Mr. Thralls' duties as an employee of the Reconstruction Finance Corporation entailed his representation of its interests in the numerous other corporations, forming the so-called Prudence Group of mortgage and real estate companies, of which the Debtor had been one (R. 175, 291). The interest of the Reconstruction Finance Corporation in these Prudence companies arose out of a $20,000,000 loan which it had made in 1932 to The Prudence Company, Inc., the loan being guaranteed by the New York Investors, Inc., and secured by the stock interests of that corporation in a number of companies, including the Debtor (R. 172, 174). In some of these corporations, such as the Debtor, there is a large public creditor interest superior to that of Reconstruction Finance Corporation; in others there is not (R. 145). As special representative of Reconstruction Finance Corporation, Mr. Thralls, in addition to his connection with the Debtor, became and now is a director and president of Allied Owners Corporation (R. 307), a director of Realty Associates, Inc. (R. 307); a director of Prudence-Bonds Cor-

poration (R. 308); a director and chairman of the Executive Committee of the Prudence Realization Corporation (R. 309); a director of Prudence Securities Corporation (R. 310); a director, vice-president and general manager of 58-59 Realty Corporation (R. 310); a director, vice-president and general manager of the Amalgamated Properties (R. 311), and a director of Hotel Taft (R. 311).

Many of these corporations have had and continue to have business transactions with the Debtor (R. 309-311, 322-324) and this is particularly true of Realty Associates, Inc., which shared offices and officers with the Debtor under an arrangement whereby the Debtor paid 67½% and Realty Associates, Inc. 32½% of the expenses involved (R. 45, 46).

The conflict of interest between the Debtor and several of these corporations is patent. In one instance, the Debtor owns the equity in real estate and Prudence Bonds Corporation owns the mortgage (R. 322); in another, the Debtor owns senior bonds and Prudence Realization Corporation the subordinate bonds of The Prudence Company, Inc. (R. 147). Transactions between Realty Associates, Inc., and the Debtor have resulted in several situations where the Debtor owns the mortgage and Realty Associates, Inc., the equity (R. 294).

When these corporations have business dealings with the Debtor, they concern matters where their respective interests are necessarily adverse (R. 146, 294, 322).

Mr. Thralls' admitted practice as a director of the Debtor bears on the necessity for the determination by the Circuit Court of Appeals that he should not be a trustee. When one of these transactions occurred between the debtor and a corporation of which he was director Mr. Thralls would partictipate in the discussion on both Boards and give his opinion (R. 323). He would try to

persuade his fellow members and get them together on what he considered a fair price (R. 324). He saw no conflict between his duty as a director of the prospective seller and as a director of the prospective purchaser (R. 322, 323). Though, perhaps to conform to some corporate ritual, he would not vote on the transaction (R. 322).*

These conflicts are further aggravated by the sharp division of interests between the bondholders and the sole common stockholder of the Debtor, the only classes affected by these proceedings. The bondholder seeks payment of the obligation due him, the common stockholder wants the assets held in the hope that in the future a greater price may be realized. Mr. Thralls went on the Board of Directors of the Debtor to represent and protect the interests of the common stockholder in the picture as against anybody else (R. 318, 319). True, as petitioners state, the proposed sale of any asset must be submitted to the court for its approval (R. 323, 354). But (and what may be more important to the bondholders) the determination not to sell, to refuse an offer, is one on which the parties are not heard and the court is not consulted. In that negative decision the operating trustee plays a major role and he, in this instance, is under a cross-fire of conflicting loyalties.

We submit that the Circuit Court was compelled to conclude that an officer of the Court could not be placed in such a position; that one who had such dual interests and was subject to such conflicting loyalties could not be a trustee.

The Court below, therefore, held that the prohibition contained in section 158 (4) against the appointment of one having a materially adverse interest applied equally to an additional trustee. To have held otherwise (that

*As a trustee, he has adopted the identical practice under similar circumstance (*post*, p. 10).

an additional trustee may be appointed though he has a materially adverse interest) *would have been to overrule the heretofore unquestioned substantive rule that one may not be appointed an officer of the Court if he is subject to conflicting loyalties arising out of dual interests that he represents.* That doctrine is hardly a novel one requiring review by this Court. Chief Justice Stone has stated that this basic principle embodies "the precept as old as holy writ, that 'a man cannot serve two masters'. * * * No thinking man can believe that an economy built upon a business foundation can long endure without loyalty to that principle." The Public Influence of the Bar, 48 Harv. L. Rev. 1, 8.

The Court below did not hold broadly that all of Section 158 applies to an additional trustee, which petitioners assume was the holding of the Court in their statement of the "Questions Presented". It merely held that the additional trustee could not have materially adverse interests, forbidden expressly by Section 158 (4), forbidden not only by that subdivision but by repeated decisions applicable to trustees in bankruptcy* (*Wilson* v. *Continental Building & Loan Association,* 232 Fed. 824; Cf. *In re National Public Service Corp.,* 68 F. [2d] 859, 863), equity receivers (*In re Norcar Mfg. Co.,* 109 F. [2d] 407, 411 and fiduciaries generally [*Michoud* v. *Girod,* 4 How. 503; *City Bank Farmers Trust Co.* v. *Cannon,* 291 N. Y. 125, 131]). So too has this rule been consistently applied to fiduciaries in reorganization proceedings: to the director of a debtor in possession (*In re Los Angeles Lumber Products Co.,* 46 F. Supp. 77) and to committee members (*Woods* v. *City National Bank & Trust Co.,* 312 U. S. 262; *In re Mountain States Power Co.,* 118 F. [2d] 405).

*Section 45 requires only that a bankruptcy trustee be "competent" and reside or have an office in the judicial district.

This Court stated in *Michoud* v. *Girod, supra*:

> "The general rule stands upon our great moral obligation to refrain from placing ourselves in relations which ordinarily excite a conflict between self-interest and integrity. * * * In this conflict of interest the law wisely interposes. It acts not on the possibility that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty (p. 555). * * *
>
> Is it not better that the cause of the evil shall be prohibited, than that courts of equity shall be relied upon to apply the remedy in particular cases, by inquiring into all the circumstances of a case, whether there has or has not been fraud in fact?" (p. 557).

And its language in *Woods* v. *City National Bank & Trust Co., supra,* is particularly pertinent.

> "A fiduciary who represents security holders in a reorganization may not perfect his claim * * * by insisting that although he had conflicting interests, he served his several masters equally well or that his primary loyalty was not weakened by the pull of his secondary one" (p. 269).

Any other determination would be intolerable. If an additional trustee may have conflicting interests, as he may if the substantive rule repeated by the language of 158 (4) has no application to him, why may he not act in matters where those conflicting loyalties come into play?

There would be no statutory prohibition, and the broad judicial injunction would be held inapplicable. Judge Hand's assumption that such an appointment might stand if the "adverse interest" situations can be ascertained and if the operating trustee will withdraw from all such, in itself posits a limited application of the language of 158 (4). An application so limited would be impossible of practical enforcement. For how are these restrictions to be applied and enforced? How will the Court, or the trustee, or the creditors be assured that it is adhered to strictly. " * * * the incidence of a particular conflict of interest can seldom be measured with any degree of certainty". *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262, 268.

Despite the integrity of the additional trustee, in practice, the line of demarcation was ignored. Mr. Thralls as trustee conducted himself in the same fashion as he had as a director. The brief of the Securities and Exchange Commission to the Court below in citing one instance from the records of the District Court stated:

> "To illustrate how these precautions are operating during the trusteeship, we quote in part from an affidavit of Jerome Thralls, dated February 2, 1944, filed in the District Court but not a part of the present record:
>
> 'That when the offer of S. Knepper Realty Corp. for the purchase of the interests of the Trustees in premises 430 East 86th Street was transmitted to the Trustees, deponent (Mr. Thralls) participated in working out the arrangements which resulted in the contract for which approval is sought. That as a result of such arrangements an offer was made by the disinterested Trustees to Prudence Realization Corporation for a satisfaction

of its interest in the above mentioned second mortgage or an assignment thereof to S. Knepper Realty Corp.

That deponent discussed the proposed offer with the disinterested Trustees, and when that offer was transmitted to Prudence Realization Corporation he discussed it with his fellow directors of that corporation but did not vote thereon as such director. That after considering such offer, Prudence Realization Corporation made a counter-offer to the Trustees herein. That deponent discussed this counter-offer with the Trustees but did not vote on the question of its acceptance or rejection by them. That he arranged a conference of representatives of Prudence Realization Corporation and the disinterested Trustees herein, at which it was agreed that said Trustees would purchase from Prudence Realization Corporation its one-quarter coordinate interest in the second mortgage for the consideration of $8,500 to be paid out of the proceeds to be realized from the contract entered into between the Trustees of the Debtor and S. Knepper Realty Corporation for the purchase by said corporation of $118,000 principal amount of first mortgage certificates; a second mortgage in the reduced principal sum of $133,402 on premises known as 430 East 86th Street, and the fee to said premises.

Deponent is of the opinion that to accept the offer of S. Knepper Realty Corp. for the interests of the Trustees in premises 430 East 86th Street, including the one-quarter coordinate interest in the second mortgage owned by Prudence Realization Corporation, now under contract of sale to the Trustees of the Debtor, is to the best interests of the estate herein.' "

The only fitting comment to such adherence to what Mr. Thralls believed to be the letter of the law, in total disregard of its essential spirit, is the language of Judge Cardozo: "But 'the great rule of law' * * * which holds a trustee to the duty of constant and unqualified fidelity, is not a thing of forms and phrases. A dominating influence may be exerted in other ways than by a vote." (*Globe Woolen Co.* v. *Utica G. & El. Co.*, 224 N. Y. 483, 489.)

These encroachments in situations where the conflict of interest is obvious point the emphasis with which the Courts have repeatedly stated that if the barrier is lifted in supposedly exceptional cases the eventual destruction thereof will be inevitable.

> "Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyality by the 'disintegrating erosion' of particular exceptions. * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court." *Meinhard* v. *Salmon*, 249 N. Y. 458, 464.

When this problem of present and potential conflict was presented to the District Court, it stated:

> "The Court has full faith in the judgment of the disinterested trustees whom it has appointed and if a situation should arise where there is any conflict of interest, the Court believes that Mr. Thralls will come forward and so state to the Court. Certainly the disinterested trustees and the attorneys for the trustees will also call the attention of the Court to any such instance. We also have a great number of attorneys who have appeared in

this proceeding and they would call the Court's attention to any evidence of that character" (R. 354).

The assumption that it suffices if all parties to the proceeding act as watch-dogs of the Court's appointee creates a situation so dangerous and so fraught with the possibility of evil as to demand and compel removal from trust obligations. "What is struck at * * * is not only actual evil results but their tendency to evil in other cases." (*Weil* v. *Neary*, 278 U. S. 160, 173.)

The Circuit Court of Appeals did no more than apply this salutary rule to the instant case—a principle which has long since been settled by this Court.

We respectfully submit that such a determination does not require review by this Court.

II.

Petitioners are not aggrieved by the decision of the Circuit Court of Appeals and, therefore, are not entitled to review the order removing Mr. Thralls.

We feel so strongly that there is no question for consideration by this Court, and that this petition should be disposed of upon that ground that we hesitate to burden the Court with the contention that in any event these applicants have no right to maintain this appeal, yet it would seem that that is so.

The petition for the writ assumes that the rights of petitioners have been adversely affected by the removal of Mr. Thralls. That assumption is palpably fallacious. No one, not *even Mr. Thralls*, may any more claim to be aggrieved by the removal than would have been the case if the District Judge had refused to appoint him on the approval of the reorganization petition and, of course, no

one's rights could have been adversely affected by such refusal.

Section 160 of the Bankruptcy Act provides that "* * * *the judge, at any time, without or upon cause shown, may* * * * *remove trustees* * * *." (Italics ours.)

The plain import of this section is that a trustee does not, by his appointment, acquire a right to continue in the office and, as a corollary to the absence of such a right, neither the debtor, nor any stockholder or creditor of the debtor has any right to a particular individual's continuance in office. From this it is manifest that neither a removed trustee* nor anyone else is in a position to review an order of *removal.* The statute has conferred upon the judge the *absolute* right to dispense with the services of a trustee at any time and no one can assert that the removal violates a right to have the trustee continue to serve. Nor is there any statutory provision which vests in any party the right to assert that any particular person be appointed or continued as trustee.

Of course, a debtor, or a stockholder or creditor of the debtor, may move, at any time, for a trustee's removal "upon the ground that he is not qualified or not 'disinterested' as provided in Section 158" of the Act (see Section 162) and, if removal be denied, the moving party would be aggrieved for the obvious reason that the continuance of the trustee in office may cause injury and damage.† *That was the position of the respondents on*

*Thralls evidently recognizes that he has no right of appeal from the decision removing him. See *Bosworth* v. *Terminal R. R. Association*, 174 U. S. 182, 189, in which the court held that a receiver in an equity proceeding "may not appeal from the order discharging or removing him". Corpus Juris Secundum, Vol. 4,§203, p. 383 states that " * * * a receiver (or trustee appointed by the court) may * * * not appeal from an order or decree removing or discharging him or vacating his appointment * * *."

†Remington, in his work on Bankruptcy, 5th Ed. Vol. 8, Section 3755, says that "*Creditors* * * * have standing to review orders appointing trustees". The omission to state that creditors have the right to review an order removing a trustee is significantly indicative that such a right is *non-existent* because removal does not and cannot conceivably result to their prejudice.

the appeals which resulted in the decision removing Thralls.

It follows, therefore, that while parties may be adversely affected by an order *denying removal* of a trustee and may appeal therefrom, *no one is aggrieved by an order removing a trustee* and an appeal from such an order will not lie. Had the District Judge refused to appoint Thralls or, having appointed him, granted the motion for his removal or sustained the objections to his continuance, petitioners could not have appealed from the order because they would not have been aggrieved. So too they may not review the decision of the Circuit Court of Appeals removing him.

Nor may it be urged that because the removal was by the decision of the Circuit Court of Appeals and not by the District Judge, the situation is different so far as petitioners' interests are concerned. Such an argument would be untenable for the effect of the decision of the Circuit Court of Appeals is the same as if it were the decision of the District Judge in the first instance. This court held in *Keller* v. *Potomac Electric Power Company*, 261 U. S. 428, 443, that a decision of an appellate court in an equity cause, reversing the District Court, is to be treated as though it were the determination of the District Court on its original disposition of the matter. Thus, the question whether petitioners are aggrieved must be regarded as though the District Judge had granted the motion for Mr. Thralls' removal or had refused to permit him to continue in office over the objection of the committee and other bondholders. In such case petitioners would not have the right to appeal from the District Court's order and, accordingly, they are not entitled to review the decision of the Circuit Court of Appeals.

Mr. Thralls is a director of the debtor; a director, vice-president and general manager of petitioner Consolidated Realty Corporation which owns all the capital stock

of the debtor; and a director, vice-president and general manager of petitioner Amalgamated Properties, Inc. It is quite understandable that petitioners are disappointed and, perhaps, chagrined that Mr. Thralls may no longer act as a trustee of the debtor and, in such capacity, to some extent control the destinies of the debtor. But that disappointment or chagrin is not tantamount to aggrievement which, in law, entitles one to appeal from the decision removing him from the office of trustee. The decision of the Circuit Court cannot possess the petitioners with a right which statutory mandate not only did not give them but in fact denied to them.

The language of this court in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 125-127, is peculiarly appropriate:

> "A Debtor * * * who invokes the aid of the Federal Courts in reorganization * * * assumes all the consequences which flow from that jurisdiction * * *. The court need not keep the debtor in possession but may substitute for the old management a trustee * * *. He (the debtor) invokes that jurisdiction risking all the disadvantages which may flow to him as a consequence, as well as gaining all the benefits * * *. *The right to remain in unmolested dominion and control over the property was necessarily waived or abandoned on invoking the jurisdiction of the Federal Courts in these proceedings.*" (Italics ours.)

As to petitioners, it may be said, as the court wrote in *In re Michigan-Ohio Building Corporation*, 117 Fed. 2nd 191, 193:

> "They are in no wise aggrieved; they are deprived of no property or right; upon them is im-

posed no burden. If there are ever to be any consequences resulting to their injury, they are not reflected by the record. Nothing would justify us in concluding that they are even remotely affected by the decree."

Because petitioners are not aggrieved by the decision removing Mr. Thralls as a trustee of the debtor, they may not be allowed a writ to review such decision.

III.

The Petition for Writ of Certiorari Should Be Denied.

LLOYD B. KANTER, JULIUS SILVER,
Counsel for Bondholders' Protective Committee, Respondents.

PERCIVAL E. JACKSON,
Counsel for John Vanneck, Barbara B. Vanneck, Equitable Holding Corporation, Vanneck Realty Corporation and Frank Bailey, Respondents.

ARCHIBALD PALMER,
Counsel for Anna Kuhlmann and Catherine Kuhlmann, Respondents.

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 414

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, DEBTOR, AND AMALGAMATED PROPERTIES, INC., PETITIONERS

v.

EDWIN B. MEREDITH, JACOB R. SCHIFF, AND MILTON C. ZAIDENBERG, CONSTITUTING THE BONDHOLDERS' PROTECTIVE COMMITTEE; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION AND FRANK BAILEY; ANNA KUHLMANN AND CATHERINE KUHLMANN, ET AL.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

PRELIMINARY STATEMENT

Proceedings for the reorganization of Realty Associates Securities Corporation under Chapter X of the Bankruptcy Act are pending in the District Court for the Eastern District of New York (R.

35). The Securities and Exchange Commission, pursuant to Section 208 of the Bankruptcy Act (Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 894, 11 U. S. C. § 608), became a party to the proceedings (R. 2). The district court appointed two trustees and an "additional trustee", Jerome Thralls (R. 69). Appeals to the circuit court of appeals were taken from two orders of the district court (R. 114, 359) which respectively denied a motion to vacate the appointment of Jerome Thralls as "additional trustee" of the debtor (R. 112–3) and overruled objections to his continuance in office (R. 355–8). The Commission opposed the retention of Thralls as additional trustee in the district court (R. 341–2) and in the court below. The orders of the district court were reversed by a divided circuit court of appeals (R. 373–8). The purpose of this memorandum is to endeavor to show that the decision of the court below is correct.

OPINIONS BELOW

The opinion of the circuit court of appeals reversing the orders of the district court (R. 373–7) and the dissenting opinion of Judge Learned Hand (R. 377) have not yet been officially reported. The formal opinion of the district court (R. 352–4) is reported in 54 F. Supp. 785.

JURISDICTION

The decree of the circuit court of appeals was entered August 8, 1944 (R. 378). The petition

for a writ of certiorari was filed August 30, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether an additional trustee appointed under Chapter X of the Bankruptcy Act is disqualified from such trusteeship by reason of conflicting interests arising out of dealings between the debtor estate and other corporations in which he is interested as officer or director.

STATUTES INVOLVED

The following sections of the Bankruptcy Act, as added by the Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 840, are set forth in the Appendix, *infra*:

Section 156 (11 U. S. C. § 556)
Section 158 (11 U. S. C. § 558)
Section 189 (11 U. S. C. § 589)

STATEMENT

Voluntary proceedings for the reorganization under Chapter X of the Bankruptcy Act of Realty Associates Securities Corporation, hereinafter referred to as the debtor, were instituted on September 28, 1943 (R. 35). The debtor is a mortgage investment company engaged in making mortgage loans, dealing in mortgages and other real estate interests, and managing properties acquired through or in lieu of foreclosure (R. 35, 204–5).

This business, together with that of an affiliate company (Realty Associates, Inc.) not in reorganization, has been managed for many years by a group of officers headed by Frank Fox, president, and Harry D. Burchell, principal vice president (R. 45–6, 66, 178, 205, 234–5, 263–4, 270). At the time the debtor's petition was filed, the debtor was defraying 67½% of the salaries of the officers and employees engaged in the joint operation of the debtor and Realty Associates, Inc. (R. 46, 66). By the terms of the *ex parte* order approving the petition the district court, pursuant to Section 156 of the Act, appointed two reorganization trustees and authorized them to continue the employment of all the officers and to adopt the existing apportionment of salary expenses between the affiliated companies (R. 69–70). At the request of the debtor (R. 47) the court also appointed Jerome Thralls as additional or "operating" trustee for the purposes specified in Section 189 of the Act (R. 69).

Subsequent to taking office, the trustees decided to terminate, at least for the period of the reorganization, the combined operations with Realty Associates, Inc. Accordingly, the services of certain executives (including Fox) and other employees not needed for the debtor's operations were discontinued (R. 195, 205, 224–6, 256–7). Those remaining with the trustees were to devote full time to the debtor's affairs, were not to partici-

pate in the operation of the affiliated company (although joint offices are still maintained (R. 230)), and were to receive all of their compensation from the trust estate. Pursuant to this internal reorganization, Burchell is serving as senior officer in charge of operations, assisted by subordinate officers who supervise particular departments of the business (R. 202, 205–6, 263). In the opinion of the reorganization trustees the staff retained by the trustees is competent and adequate for the purposes or foreseeable demands of the business and no branch of the business is being neglected (R. 205–6, 208, 226).

Thralls became a director of the debtor in 1935 by reason of his position as Special Representative of the Reconstruction Finance Corporation (R. 173, 296, 353) which then held all the capital stock of the debtor as pledgee (R. 172). In 1939 the RFC became the absolute owner of this stock by foreclosure and thereafter transferred it to a wholly owned subsidiary, Consolidated Realty Corporation, which is one of the petitioners herein (R. 172). Thralls became and still is vice president and general manager of the Consolidated Realty Corporation (R. 173) and has held its proxy to vote the debtor's shares (R. 296). Since 1939 Thralls has been a member of the debtor's executive committee (R. 305). He has received compensation from the RFC for his services and in addition has received the usual fees from the

debtor as a director and member of the Executive Committee (R. 306, 67, 173, 315–6). He was never an operating officer of the debtor (R. 172–6). He testified he spent one 18-hour day a week on the affairs of both the debtor and Realty Associates, Inc. (R. 334, *cf.* 326). He makes his offices with the RFC rather than with the debtor (R. 230, 317).

In the matters in which the RFC is interested, including the debtor, Thralls' primary obligation is to protect the interests of the RFC (R. 318–9, 330). Moreover, as Special Representative of the RFC, he has connections as director or officer with the so-called Prudence group of companies which includes the debtor (R. 175, 307–11) and is in charge of the liquidation of a large RFC loan to the companies in this group (R. 173–4, 307). The interests of these companies, with which the debtor has had relationships in the past and with which the trustees will continue to have business transactions (R. 309–11), are adverse to the estate (R. 324). One of these companies is Realty Associates, Inc., of which Thralls is a director (R. 307). The stock of Realty Associates, Inc., like that of the debtor, is owned by petitioner Consolidated Realty Corporation (R. 66, 103). There have been instances where the two companies have embarked upon joint ventures with the result that the debtor holds mortgages on property in which Realty Associates, Inc. owns the equity. In other

situations, Realty Associates, Inc. holds a junior interest or participation in mortgages in which the debtor has the senior interest. As respects others of these companies, the debtor is in many instances the equity owner or junior participant and the other corporation in which Thralls has an interest is the mortgagee or the senior holder (R. 322). When such transactions have occurred prior to the debtor's reorganization Thralls has refrained from voting on the question although he has participated in the discussions and negotiations (R. 322–3).

The district court denied an application for an order vacating Thralls' appointment as additional trustee (R. 112–3) and overruled objections to his retention in office (R. 355–8). On January 28, 1944, the district court filed a formal opinion (R. 352–354). The circuit court reversed these orders of the district court. (R. 378).

ARGUMENT

I

The circuit court of appeals, in our opinion, properly held Thralls to be disqualified from serving as additional trustee by reason of his connections with companies whose interests are adverse to the interests of the creditors of the debtor and who have constant dealings with the estate.

We believe a clearer idea of the issues involved may be obtained by an examination of the status

of the case in the court below and the arguments presented to it by the respondents to support their claims that the additional trustee is disqualified. The arguments were as follows:

First, it was argued that the policy of Chapter X, as shown by its legislative and historical background, confines the appointment of additional trustees to the exceptional case. It contemplates the appointment of officers or directors as additional trustees only if they are active operating men whose services and experience are essential to the business operations of the trusteeship and only when these services cannot be obtained through their employment by the reorganization trustees.[1] The record was cited to show that Thralls' services were not needed because Burchell and other active operating officers of the debtor were employed by the trustees and that Thralls had not taken an active part in the operations of

[1] Representative Chandler, reporting the bill to the House, explained the purpose of the amendment in a formal statement as follows:

"Appointment of cotrustees (sec. 156): The Senate has deemed it advisable to amend this section so as to make it possible for the judge to appoint an officer or employee of the debtor as cotrustee for the single purpose of aiding in the management and operation of the debtor's business or property. *In the unusual case this may be desirable, and the Senate amendment supplies flexibility in this regard.* Since the disinterested trustee is empowered to employ officers of a debtor (sec. 191), such appointment of a cotrustee would not be necessary in the ordinary case." (Italics supplied) [83 Cong. Rec. 9107 (75th Cong., 3d Sess., June 13, 1938)].

the debtor before it filed its petition. We also urged this position in the court below and placed major emphasis on it. That court, however, found it unnecessary to pass on either the construction we urged or Thralls' qualifications under that construction. The court did state that "Regardless of which construction is correct it would seem that usually, in the interest of economy in administration, an 'additional', i. e. operating, trustee should not be appointed when the disinterested trustees retain in their employ the top operating officers and employees of the debtor" (R. 375).

Second, respondents urged that directors, officers or employees appointed as additional trustees under Section 156 of Chapter X are disqualified to serve under Section 158 (1) if they are stockholders or represent stockholders of the debtor. The record showed that Thralls, while not himself a creditor or stockholder of the debtor within the letter of subdivision (1), is vice-president and general manager of Consolidated Realty Corporation which is the sole stockholder of the debtor. We did not support this argument because we found difficulty in reconciling the provision for appointment of a director or officer as additional trustee with the disqualification of persons owning stock of the debtor in Section 158 (1); in the absence of a clear legislative declaration we hesitated to urge that the doubt be resolved by narrowing the

class from which additional trustees, when needed, might be selected. The court rejected the respondents' argument in this respect on the ground that the last sentence of Section 156, allowing the appointment of a director as an additional trustee, "implicitly removes the disqualification specified in section 158 (1) arising from ownership of the debtor's stock, since directors usually do own some stock" (R. 376).

Third, respondents contended that the basic policy of the Act to exclude "friendly" trustees from the reorganization process requires the appointment of additional trustees free of interests adverse to those of the estate. The record shows that Thralls, as Special Representative of the R. F. C., has connections as director or officer with corporations whose interests are in conflict with those of the estate. These are other companies in the Prudence group with which the debtor has had and is continuing to have business transactions. That this conflict is real is apparent from the fact that Thralls, although participating in the discussions and negotiations, has refrained from voting on questions involved in such transactions. We urged that these adverse interests disqualified the additional trustee.

The circuit court based its decision on this ground. The court concluded that the standards of disinterest specified in Section 158 are applicable to additional trustees except as modified, explicitly or implicitly, by the last sentence of

Section 156. It found that under subdivision (4) of Section 158 Thralls was disqualified because of interests conflicting with those of the estate.

We agree with this result. We believe it is immaterial whether the decision is based on Section 158 (4) or, as we argued in the court below, upon well-established equity receivership and bankruptcy principles inherent in the structure of Chapter X requiring trustees to be free from conflicting interests.[2] Because of our difficulty in reconciling the applicability of the stockholder provisions of Section 158 (1) to additional trustees, we avoided an argument depending upon any portion of Section 158. However, the manner in which the court below excluded the stockholder

[2] In ordinary bankruptcy, where Section 45 (11 U. S. C. 73) does no more than require a trustee to be "competent", the courts have expanded the term to require not only capability to perform the functions of a trustee but also freedom from "all entangling alliances or associations that might in any way control his complete independence and responsibility." See *In re Rekersdres*, 108 Fed. 206 (S. D. N. Y. 1901); see also *In re Lewensohn*, 98 Fed. 576 (S. D. N. Y. 1899). Cf. Section 157 (11 U. S. C. 557). Broad principles of disqualification arising from prejudicial associations were developed by the courts sitting in equity receiverships. See *Coy* v. *Title Guarantee & Trust Co.*, 157 Fed. 794 (1907); *Olmstead* v. *Distilling & Cattle Feeding Co.*, 67 Fed. 24 (C. C. N. D. Ill. 1895). Since the Chapter X court and its officers have the powers and duties, not inconsistent with the statute, which prevail in bankruptcy and equity receivership proceedings, the applicability of these general standards seems clear (see Secs. 114, 115, 187; 11 U. S. C. 514, 515, 587). In addition Section 156 requires that Chapter X trustees have the qualifications (other than residence) prescribed by Section 45.

disqualification in Section 158 (1) and applied the consistent portions of Section 158 appears to us to be a satisfactory solution of the difficulty.[3] The standards imposed by the court below pursuant to Section 158 (4) are identical with those which we urged as applicable independently of this provision. Regardless of the basis of the decision, it accords with the general purpose of Congress to place control of the estate during reorganization in the hands of impartial and disinterested trustees. Certainly the limited authorization for the appointment of an additional trustee was not intended to alter the inflexible rule that persons with such prejudicial associations are not competent to serve as trustees. There is no basis in fact for petitioners' criticism that the decision of the court below "unduly restricts the class from which Additional Trustees

[3] The basic necessity for impartiality and disinterestedness in court officers was recognized early in the history of equity receivership reorganizations. See *Atkins* v. *Wabash, St. L. and P. Ry Co.*, 29 Fed. 161, 173–174 (C. C. N. D. Ill. 1886); *Finance Co. of Pa.* v. *Charleston, C. & C. R. Co.*, 45 Fed. 436 (C. C. S. C. 1891). The relaxation of these standards in equity receivership and under Section 77 B of the Act (see *In re King's Brewery, Inc.*, C. C. H. Bankr. Serv., Par. 3116 (E. D. N. Y. 1934)) led to the enactment of Section 156 in its present form. Sen. Rep. No. 1916, 75th Cong., 3rd Sess. (1938) pp. 21, 27, 28. As the Senate Report stated: "Section 156 puts an end to the general practice of leaving the debtor in possession, or of appointing 'friendly' trustees, including officers of the debtor corporation, in proceedings under section 77B."

may be appointed" (Pet. 12). For while officers and directors usually hold stock, it is not true in any substantial number of cases that officers or directors will have conflicting interests of the type prohibited by the decision of the court below.

II

The circuit court properly held that Thralls' disqualification under Section 158 (4) cannot be waived either because of his integrity or because of his promise not to vote in decisions involving the conflicting interests of the other companies in the Prudence group. The dissenting opinion, while agreeing with the majority's interpretation of Section 156, felt that Thralls might be retained if the district court in its discretion was certain that Thralls would take no part in transactions in which he has "an interest materially adverse to the interests of any class of creditors" (R. 377). The dissenting judge assumed that each transaction involving a conflict could be ascertained and that the additional trustee "will withdraw from all such". (R. 377). These views run counter to the underlying purpose of the Act which was to fix standards for the appointment of trustees and, where materially adverse interests exist, not to leave such appointments to the discretion of district judges who might be oversanguine as to their ability to avoid the dangers

inherent in the appointment of trustees with such conflicting loyalties.

In the past and during these proceedings, Thralls has not withdrawn from transactions involving a conflict of his loyalties. He has merely refrained from voting on them, but has participated in the discusions and negotiations leading to those transactions. Whether or not this procedure is in accord with conventional corporate practice where there are interlocking directorates, we do not believe a court should rely on such limited precautions to insulate against conflicting interests of trustees. The high quality of the fiduciary obligations imposed upon a trustee, even an additional trustee, do not permit of such dual interests. It is not appropriate to speculate that because of the integrity of the particular individual actual harm will not occur, nor is it a sufficient safeguard that he and others who work with him are charged with the responsibility of bringing the conflicts into the open (R. 354). For, as this Court has stated in comparable situations, "the incidence of a particular conflict of interest can seldom be measured with any degree of certainty." *Woods* v. *City National Bank and Trust Co. of Chicago,* 312 U. S. 262, 268 (1941). "What is struck at . . . is not only actual evil results but their tendency to evil in other cases." *Weil* v. *Neary,* 278 U. S. 160, 173 (1929).

CONCLUSION

For the reasons stated, the Commission believes the decision below is correct.

Respectfully submitted.

ROGER S. FOSTER,
Solicitor,
MILTON V. FREEMAN,
Assistant Solicitor,
GEORGE ZOLOTAR,
W. VICTOR RODIN,
KIVA BERKE,
Attorneys,
Securities and Exchange Commission.

I have authorized the filing of this Memorandum.

CHARLES FAHY,
Solicitor General.

SEPTEMBER 1944.

APPENDIX

The pertinent sections of the Bankruptcy Act, as added by the Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 840, are as follows:

> SEC. 156. Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.
> (11 U. S. C. § 556.)
>
> SEC. 158. A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this Act, if—
>
> (1) he is a creditor or stockholder of the debtor; or
>
> (2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

(4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.
(11 U. S. C. § 558.)

SEC. 189. A trustee or debtor in possession, upon authorization by the judge, shall operate the business and manage the property of the debtor during such period, limited or indefinite, as the judge may from time to time fix, and during such operation or management shall file reports thereof with the court at such intervals as the court may designate.
(11 U. S. C. § 589.)

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Supreme Court of the United States

OCTOBER TERM, 1944.

No. 414.

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, Debtor, and AMALGAMATED PROPERTIES, INC.,

Petitioners,

v.

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN, *et al.*,

Respondents.

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

WILLIAM P. PALMER,
Counsel for Consolidated Realty Corporation, Petitioner.

JAMES B. ALLEY,
Counsel for Realty Associates Securities Corporation, Debtor, Petitioner.

JAMES F. DEALY,
Counsel for Amalgamated Properties, Inc., Petitioner.

JOHN D. GOODLOE,
General Counsel, Reconstruction Finance Corporation, the holder of all the capital stock of Petitioner Consolidated Realty Corporation.

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Respondents.

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

This brief is submitted by petitioners, Consolidated Realty Corporation, Realty Associates Securities Corporation, Debtor, and Amalgamated Properties, Inc., in reply to the memorandum filed by the Securities and Exchange Commission (hereinafter referred to as the "SEC") and the brief in opposition filed by respondents. Except for a jurisdictional point in the latter brief, both address themselves to the merits of the result rather than to the merits of the decision below or to the question of whether the writ

should be granted. The petition raises only the question whether the Court below was required as a matter of law to disqualify the Additional Trustee by virtue of Section 158. The SEC memorandum, particularly, reargues points which did not prevail in the Court below and which are not raised by the petition.

I.

In Reply to the SEC Memorandum and Point I of Respondents' Brief.

The SEC and respondents attempt to apply to the Additional Trustee rules which were developed for entirely different situations. They state that the courts at an early date established the rule that a trustee in bankruptcy or an equity receiver could not have any interest in, or with respect to, a debtor.[1] But it was soon recognized, where the business was to be continued pending reorganization, that the operation of the business could not be turned over to strangers, and that the knowledge and experience of the former management were essential.[2] Accordingly, it became a common practice in equity receivership reorganizations to appoint co-receivers—one selected from the management and another having no prior connection with the debtor.[3]

This practice culminated in the enactment of Section 77B, where the debtor itself could be, and in most cases was, left in possession to act in all aspects of the reorganization.[4] This procedure was found to be desirable

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[1] SEC Memorandum, pp. 11-12; Respondents' Brief, p. 8.

[2] Finletter, *Principles of Corporate Reorganization*, pp. 190, 193-194.

[3] Gerdes, *Corporate Reorganizations: Changes Effected by Chapter X of the Bankruptcy Act* (1938) 52 Harv. L. Rev. 1, 10.

[4] 11 U. S. C. A. §207(c); H. R. Rep. No. 1409, 75th Cong. 1st Sess. (1937) 37.

in many cases since reorganization proceeded more expeditiously and the going concern value was better preserved, but in some cases it opened the door to fraud and oppression. It permitted the debtor (in effect the management) to conduct the investigation into the desirability of continuing the business, competence of the management and possible causes of action against the officers and directors, and to prepare the plan of reorganization.

Because of these defects which, in a few cases, permitted an incompetent, or even dishonest, management to continue itself in office or force through a plan of reorganization not in the best interests of all parties, the SEC and the Committee on the Judiciary of the House of Representatives recommended a provision requiring the appointment of only disinterested trustees in every reorganization where the liabilities exceeded $250,000[5] This proposal was passed by the House as part of the Chandler Bill (H. R. 8046), but raised such a protest at the Congressional hearings that the Senate Committee amended the Bill to keep the best features of both the Chandler Bill and 77B.[6] Investigation of the conduct of the business and preparation of the plan of reorganization were left exclusively to the disinterested trustee,[7] but, for the operation of the business, a new position was created which was totally unprecedented and, for lack of a better title, was designated as the Additional Trustee. This officer was denied any

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[5] SEC, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, Part I, p. 899; H. R. Rep. No. 1409, 75th Cong., 1st Sess. (1937) 42-43.

[6] Hearings before a Sub-Committee of the Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2nd Sess. (1937-1938) 20, 29-30, 103, 200-201; Sen. Rep. No. 1916, 75th Cong., 3rd Sess. (1938) 27-28; see also Hearings before the House Committee on the Judiciary on H. R. 6439 and H. R. 8046, 75th Cong., 1st Sess. (1937) 290, 327-328, 343, 367-370.

[7] Sections 156, 167, 169.

function in the reorganization, except to assist the disinterested trustee in the operation of the business.[8] Thus, the long conflict was resolved. The debtor would be permitted to suggest to the Court a man familiar with its affairs to assist the disinterested trustee in the operation of its business, thereby preserving the assets and the going concern value for the creditors and stockholders, but any such person would be completely divorced from all other aspects of the reorganization. Thus, the Bill, as finally enacted, fully met the basic requirements of the SEC and the House Committee by vesting exclusively in disinterested trustees the investigation of the business and the desirability of the continuance thereof, the preparation of a plan of reorganization and reports to the Court thereon.

Under Chapter X, more stringent rules of disinterest are imposed on the trustee having general control over the reorganization than were imposed in bankruptcy, equity receiverships or 77B. On the other hand, Congress did not impose any limitations on the qualifications of the Additional Trustee, except to require that he *must* be a director, officer or employee. Indeed there was no reason to impose any further restriction since the Additional Trustee acts only in a limited capacity. Congress has now specifically required that the Additional Trustee be selected from the class of persons having the type of interest most likely to be adverse to creditors and which would automatically disqualify them from acting as trustees in straight bankruptcy. It is implicit in this basic change that Section 158 and the rules of disqualification applicable to trustees in straight bankruptcy or equity receivers do not apply to the Additional Trustee.

The Court below recognized this to the extent of conceding that the disqualification of stockholders in Section

[8] Sections 156, 189. See also Fifth Annual Report of SEC, p. 12.

158(1) would be inapplicable (R. 376). The Court's reason was that it is a common occurrence for a director or officer to be a stockholder. But it is also common, in cases involving large corporations with liabilities in excess of $250,000, for directors and officers to be creditors or bondholders of the debtor or directors of corporations dealing with the debtor. The only proper conclusion is that under Chapter X no part of Section 158 or the general rules of disqualification of trustees is applicable to the Additional Trustee. Of course, the Additional Trustee must be a person of integrity having the ability required to discharge the duties imposed upon him. Nothing more is necessary since he acts solely in the operation of the business in conjunction with the disinterested trustee and under the supervision of the Court. The exercise of such supervision is within the sound discretion of the Court. In this case, for example, the District Judge has established a procedure to eliminate the possibility of any harm to the creditors, which is in line with the view expressed by Judge Learned Hand (Pet. 6, 16).

There is no warrant for a construction of Sections 156 and 158 of Chapter X which, on the one hand, would permit an Additional Trustee to have the basic conflicts inherent in the appointment of a director, officer, employee, stockholder or creditor, any of which would disqualify a bankruptcy trustee, and, on the other hand, would disqualify the Additional Trustee because of his connection with other corporations which are likely to have business dealings with the Debtor.

II.

In Reply to Point II of Respondents' Brief.

The District Judge has found that the Additional Trustee's "advice, assistance and direction were very essential to the management of the business and that his continuance may be regarded as a necessity * * * [and] to a large degree indispensable" (R. 353-354). It is disingenuous to argue, in the face of this finding, that the reversal by the Court below of the Additional Trustee's appointment strictly on a point of law does not injure the petitioners who are the stockholder of the solvent Debtor, the Debtor itself, and a large bondholder of the Debtor (Pet. 1-2, 4).

The findings of the District Court are amply supported by the evidence (Pet. 4-5). Other bondholders and the Indenture Trustee, who filed briefs in the Court below in opposition to the removal of the Additional Trustee, agreed that the best interests of the estate required his continuance in office. The Court below did not question the findings of the District Court and, over the opposition of respondents, granted a stay of the issuance of its mandate pending final disposition by this Court of the legal point involved.

The questions whether an Additional Trustee can himself appeal and what would happen if the District Court should remove him at will under Section 160 of the Bankruptcy Act are totally irrelevant. In this case, the District Court found that the Additional Trustee was essential and refused to remove him; the Court below reversed, not as a matter of discretion but only on the ground that Section 158 constituted an absolute disqualification; and the petition for

a writ of certiorari has been made by three parties having a substantial interest in the reorganization.[9]

Section 24 of the Bankruptcy Act, which is set forth in the Appendix hereto, makes it clear that, after a finding that the services of the Additional Trustee are essential, a judgment of the Circuit Court reversing, on legal grounds, orders retaining him in office is subject to review in this Court on application by any party in interest.

Respectfully submitted,

WILLIAM P. PALMER,
Counsel for Consolidated Realty Corporation, Petitioner.

JAMES B. ALLEY,
Counsel for Realty Associates Securities Corporation, Debtor, Petitioner.

JAMES F. DEALY,
Counsel for Amalgamated Properties, Inc., Petitioner.

JOHN D. GOODLOE,
General Counsel, Reconstruction Finance Corporation, the holder of all of the capital stock of Petitioner Consolidated Realty Corporation.

I have authorized the filing of this brief.

CHARLES FAHY,
Solicitor General.

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[9] Appeals from orders refusing to appoint a Trustee have been entertained in the following cases: *In re Philadelphia & Reading Coal & Iron Co.*, 104 F. (2d) 126 (C. C. A. 3rd, 1939) (Order denying motion in 77B proceeding pending at the time of the enactment of Chapter X to compel the appointment of a Trustee under Section 156 of Chapter X); *In re Philadelphia & Reading Coal & Iron Co.*, 105 F. (2d) 354 (C. C. A. 3rd, 1939) (Order denying motion to proceed with hearing on application for appointment of Trustee); see *Lansdown* v. *Faris*, 66 F. (2d) 939, 940 (C. C. A. 8th, 1933) (Railroad reorganization under Section 77 of the Bankruptcy Act).

Appendix.

SEC. 24. JURISDICTION OF APPELLATE COURTS.—a. The Circuit Courts of Appeals of the United States and the United States Court of Appeals for the District of Columbia, in vacation, in chambers, and during their respective terms, as now or as they may be hereafter held, are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy, either interlocutory or final, and in controversies arising in proceedings in bankruptcy, to review, affirm, revise, or reverse, both in matters of law and in matters of fact: *Provided, however,* That the jurisdiction upon appeal from a judgment on a verdict rendered by a jury, shall extend to matters of law only: *Provided further,* That when any order, decree, or judgment involves less than $500, an appeal therefrom may be taken only upon allowance of the appellate court.

b. Such appellate jurisdiction shall be exercised by appeal and in the form and manner of an appeal.

c. The Supreme Court of the United States is hereby vested with jurisdiction to review judgments, decrees, and orders of the Circuit Courts of Appeals of the United States and the United States Circuit Court of Appeals for the District of Columbia in proceedings under this Act in accordance with the provisions of the laws of the United States now in force or such as may hereafter be enacted.